Supreme Court, U.S.
FILED
SEP 8 1986
JOSEPH F. SPANIOL, JR.
CLERK

No. 86-79

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

PINE STREET BAPTIST CHURCH, et al.,
Petitioners,

vs.

SECURITIES INVESTOR PROTECTION CORPORATION
and FRED D. BRYAN, TRUSTEE,
Respondents.

On Petition For a Writ of Certiorari to the United States Court of Appeals For the Sixth Circuit

PETITIONERS' REPLY BRIEF TO RESPONDENT SECURITIES INVESTOR PROTECTION CORPORATION'S BRIEF IN OPPOSITION

ROBERT D. TUKE
FARRIS, WARFIELD & KANADAY
Nineteenth Floor
Third National Financial Center
424 Church Street
Nashville, Tennessee 37219
(615) 244-5200
Counsel for Petitioners

Of Counsel:

KATHERINE M. ALLEN
FARRIS, WARFIELD & KANADAY
Nineteenth Floor
Third National Financial Center
424 Church Street
Nashville, Tennessee 37219
(615) 244-5200

St. Louis Law Printing Co., Inc., 411 No. Tenth Street 63101 314-231-4477

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SUMMARY OF ARGUMENT

Respondent, Securities Investor Protection Corporation ("SIPC"), raised three issues in its Brief in Opposition which Petitioners did not discuss in their Petition for a Writ of Certiorari.[1] Petitioners' Reply Brief will address the following issues:

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[1] Petitioners have no parent companies, subsidiaries or affiliates to report pursuant to Rule 28.1 of this Court.

1. General rules of substantive bankruptcy law should not overrule the equitable principles applied by this Court and by other courts in insolvency proceedings.

2. The primary cases on which SIPC and the decision below rely support the Petition for a Writ of Certiorari.

3. The issue of good faith was never raised or argued at trial and was not a proper issue before the Court of Appeals.

ARGUMENT

I. The General Bankruptcy Rules Cited By Respondent Are Not Controlling.

Throughout respondent SIPC's Opposing Brief, SIPC attempts to rely on general rules of bankruptcy law to support its position. SIPC's basis for such reliance stems from the language in the Securities Investor Protection Act, 15 U.S.C. §§ 78 aaa *et seq.* (1982), ("SIPA") which applies certain sections of the federal Bankruptcy Code to the *conduct* of liquidation proceedings under SIPA. 15 U.S.C. § 78 fff(b). Applying procedural bankruptcy law to the *conduct* of proceedings and applying substantive bankruptcy law to equitable claims such as petitioners', however, are two entirely different matters. Substantive bankruptcy law does not govern, nor does it prohibit, petitioners' claims against SIPC.

As emphasized by the District Court, petitioners have asserted no claim for payment of interest against the debtor's estate or the Trustee. Rather, petitioners' claims are against SIPC to recover damages suffered from not receiving prompt payment and to recover, as a matter of unjust enrichment, monies earned by SIPC during the lengthy period it had the use of funds to which petitioners were rightfully entitled as customers under SIPA. Petitioners' interest claims are not

claims in bankruptcy and have nothing to do with the manner in which the debtor's liquidation proceeding is being conducted.

In 15 U.S.C. § 78 fff(b), SIPC clearly notes that the Bankruptcy Code provisions will apply only to liquidation *proceedings* and only "[t]o the extent consistent with the provisions of this Act." The previous section in SIPA states that one of the primary purposes of the Act shall be to satisfy customer claims "as promptly as possible." 15 U.S.C. fff(a)(1). The court below created an inconsistency with the provisions of SIPA immunizing SIPC from paying interest to petitioners after SIPC delayed in paying petitioners for over seven and one half years. The Court of Appeals rigidly applied broad rules of substantive bankruptcy law, but ignored the prevailing equitable principles followed by Courts in bankruptcy or insolvency proceedings, *see* cases cited by petitioners in their Petition for a Writ of Certiorari. The decision below conflicts not only with the provisions of SIPA itself, but with the principles upheld by this Court and by other courts in insolvency proceedings.

II. SIPC Relies On Cases In Which This Court Upheld Equitable Principles Supporting Petitioners' Claim For Interest.

In its Opposition Brief to Petitioners' Petition For Writ of Certiorari, SIPC relies heavily on two cases decided by this court, *Vanston Bondholders Protective Committee v. Green,* 329 U.S. 156 (1946), and *Nicholas v. United States,* 384 U.S. 678 (1966). SIPC asserts that petitioners' failure to mention these cases in their Petition indicates a weakness in petitioners' argument. SIPC's and the Sixth Circuit Court of Appeals' reliance on these cases is misapplied. On the contrary, the opinions in both *Vanston* and *Nicholas* support the application of equitable principles underlying the District Court's Order that SIPC must pay interest to petitioners.

Justice Black bases his entire discussion in the *Vanston* case on his recognition that equitable principles guide federal courts in all insolvency proceedings. The opinion firmly states:

> It is manifest that the touchstone of each decision on the allowance of interest in bankruptcy, receivership, and reorganization has been a balance of the equities between creditor and creditors or between creditors and the debtor.

329 U.S. at 165.

In *Vanston,* this Court decided not to enforce a contract between a creditor and the debtor which provided for interest on interest payments because enforcement of the contract would have caused other creditors to suffer a direct loss. In short, the purpose of this Court's decision to refuse interest on interest payments was to prevent unequal treatment of creditors. The decision below is in direct conflict with the principles applied in *Vanston.* The Court of Appeals refused to recognize the principle that creditors should receive ratable treatment. Instead, the court below and SIPC take a position that results in unequal treatment of petitioners by refusing to compensate petitioners for their loss of interest over seven and one half years.

Furthermore, the concurring opinion in *Vanston* clearly distinguished cases, such as petitioners', in which the awarding of interest is a proper consideration for the trial court. Justice Frankfurter, writing on behalf of four Justices, explained:

> This is not a case where damages are claimed, in the form of interest, for the detention of monies due. In such a situation the right to interest and its measure become matters for judicial determination.

329 U.S. 171 (Frankfurter, J., concurring).

In *Nicholas v. United States,* this Court again articulated that decisions to refuse interest payments in an insolvency proceeding result from the underlying rationale that creditors must

receive equal treatment. In an important footnote, the *Nicholas* court quotes from an earlier Supreme Court Case:

> If all claims were of equal dignity and all bore the same rate of interest, from the date of the receivership to the date of final distribution, it would be immaterial whether the dividend was calculated on the basis of the principal alone or of principal and interest combined. But some of the debts might carry a high rate and some a low rate, and hence inequality would result in a payment of interest which accrued during the delay incident to collecting and distributing the funds.

384 U.S. at 685, n. 12, *quoting American Iron & Steel Manufacturing Co. v. Seaboard Air Line Railway,* 233 U.S. 261, 266 (1914). The *Nicholas* opinion clearly recognized the same principle relied upon by the District Court in awarding interest to petitioners.

In the two primary cases cited in opposition to the Petition for Certiorari, this Court recognized the application of equity in *any* insolvency proceeding and the need to consider equality of treatment of creditors in deciding whether or not to award interest. As noted in their Petition, petitioners sued SIPC for damages and loss incurred by SIPC's seven and one half year delay in paying petitioners' claims. During that period, SIPC invested funds and earned a higher rate of interest than the statutory rate applied by the District Court. After fully balancing the equities among the parties, the District Court ordered SIPC to pay interest to achieve equality among the creditors in this case. The court below departed from this well-established principle by reversing the District Court's discretionary decision. The issue of a district court's authority to order SIPC to pay interest under these circumstances is important and ripe for review by this Court.

III. SIPC Failed To Raise "Good Faith" As An Issue In This Litigation.

In the second section of SIPC's Opposition Brief, SIPC argues in favor of the application of 15 U.S.C. § 78 kkk(c) by the Court of Appeals to "excuse" SIPC from having to pay interest. The Court of Appeal's reliance on 15 U.S.C. § 78 kkk(c) was faulty in two ways. First, this section was intended only to provide immunity in tort actions where SIPC acted in good faith. In contrast, petitioners have brought a quasi-contract action against SIPC. Second, SIPC did not assert good faith as an issue at trial and no evidence was presented by either side on this issue.

SIPC asserts that petitioners admitted that SIPC acted in good faith in delaying payment of funds to petitioners for over seven and one half years. Petitioners have never made such an admission. SIPC's quotes from the trial transcript were never made part of the Record on Appeal which SIPC submitted to the Sixth Circuit Court of Appeals. Moreover, such quotes, taken completely out of context by SIPC, were spoken by counsel for petitioners during closing argument in clarifying for the District Court the fact that the good faith or bad faith or fault of SIPC had not been raised as an issue in that trial.

Although SIPC did allege that it acted in good faith in its Answers to petitioners' Complaints, SIPC failed to preserve this defense for trial. Under Local Rule 11(b)(14) of the United States District Court, Middle District of Tennessee, the Final Pre-trial Order supplants all pleadings. The Final Pre-trial Order in this case specifically recited that the pleadings were amended to conform to the Order. Nothing in the Final Pre-trial Order refers to good faith as one of SIPC's defenses. The burden of raising this defense was on SIPC. Its failure to do so is why it was not an issue at trial. In fact, SIPC attempted unsuccessfully to assert this defense by letter *after* trial.

As stated in our Petition, the Court of Appeals' reliance on 15 U.S.C. § 78 kkk(c) as an alternative basis for its decision cuts against both the intent behind that section of SIPA and the Rules of Civil Procedure. This Court should grant petitioners a Writ of Certiorari to prevent such a misapplication of SIPA in the future.

CONCLUSION

For all these reasons and for the reasons cited in their Petition for a Writ of Certiorari, petitioners respectfully request that this Court issue a Writ of Certiorari and review the judgment and opinion of the Sixth Circuit Court of Appeals.

Respectfully submitted,

Robert D. Tuke

FARRIS, WARFIELD & KANADAY
19th Floor
Third National Financial Center
Nashville, Tennessee 37219
615/244-5200

Counsel for Petitioners